

## RBI raises repo rate – neutral for cost of funding

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The Reserve Bank of India (RBI) has increased the repo rate by 25bps to 8% with immediate effect.

We would like to point out three things over here:

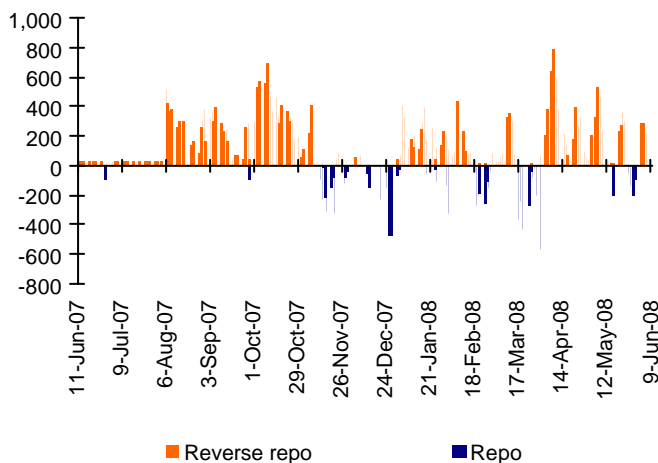
1. While, the increase in the repo rate will not impact the cost of funding for the banks (during last one year, the RBI has not received no bids under repo window for 75% of the days), Many of the PSU banks may use the occasion to roll back the PLR cut that they did in Q4FY08. We believe this will be a positive for PSU banks.
2. With major monetary tightening steps (75bps increase in CRR and 25bps increase in repo rate) taken during Q1FY08, the July review of monetary policy may be non-eventful.
3. We believe that one more round of tightening (after CRR increases) was already in price with the bond yields across the tenures having moved up by 15-20bps. In anticipation of severe monetary tightening, the banking stocks also have seen steep correction and are currently quoting at their four year low valuations which we find very attractive. Our top picks – ICICI Bank, BOI, Axis Bank, HDFC Bank and BOB

### Repo window is non-existent now

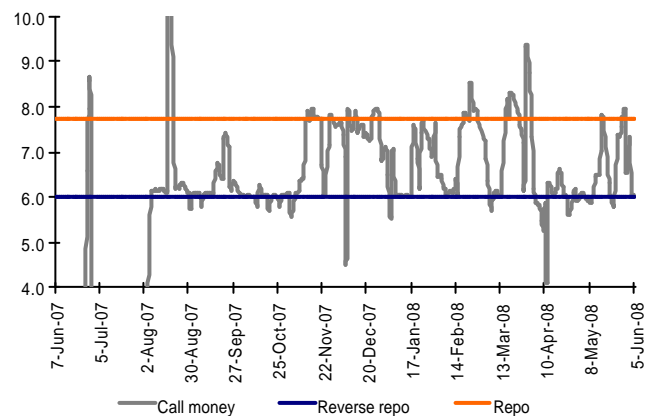
With huge amount of excess liquidity in the system, the repo window has become virtually non-existent over last one year. Through last one year, the banks have resorted to the repo window to borrow money only in 25% of the days. Of those 25% of the days, on two occasions banks resorted to the RBI to borrow money in the fortnight when CRR rate was hiked.

We believe that with the liquidity situation remaining comfortable over FY09 driven by accretion to Forex reserves and hence, we do not expect the cost funding for the banks to move up.

Repo and Reverse Repo volumes (Rs bn)



Overnight call money rate (%)



Source: RBI, Emkay Research

Liquidity: comfortable, albeit likely to be lower than last year

USD bn	Oil @ USD110/bbl				Oil @ USD130/bbl and outflow of USD8bn on portfolio investment			
	FY06	FY07	FY08E	FY09E	FY06	FY07	FY08E	FY09E
<b>Current account</b>	-9.2	-9.6	-14.8	-26.9	-9.2	-9.6	-14.8	-34.0
Trade surplus	-51.8	-64.9	-87.4	-114.1	-51.8	-64.9	-87.4	-114.1
Export of goods	105.2	127.1	160.4	190.4	105.2	127.1	160.4	190.4
Import of goods	157.0	192.0	247.9	304.5	157.0	192.0	247.9	304.5
Invisibles	42.7	55.3	72.6	87.2	42.7	55.3	72.6	87.2
Services	23.9	32.7	41.2	51.5	23.9	32.7	41.2	51.5
Remittances	24.3	27.4	37.7	42.2	24.3	27.4	37.7	42.2
<b>Capital account</b>	23.4	44.9	70.9	71.1	23.4	44.9	70.9	55.1
Loans inflows	6.1	21.1	29.6	31.3	6.1	21.1	29.6	31.3
Banking capital	1.4	2.1	3.1	3.8	1.4	2.1	3.1	3.8
Foreign investments	17.2	15.5	29.3	27.2	17.2	15.5	29.3	27.2
FDI	4.7	8.4	14.3	19.2	4.7	8.4	14.3	19.2
Portfolio	12.5	7.1	15.0	8.0	12.5	7.1	15.0	-8.0
Other foreign capital	-0.7	6.4	9.0	9.0	-0.7	6.4	9.0	9.0
Net surplus/deficit	14.2	35.3	56.1	44.2	14.2	35.3	56.1	21.1

Source: RBI, Emkay Research

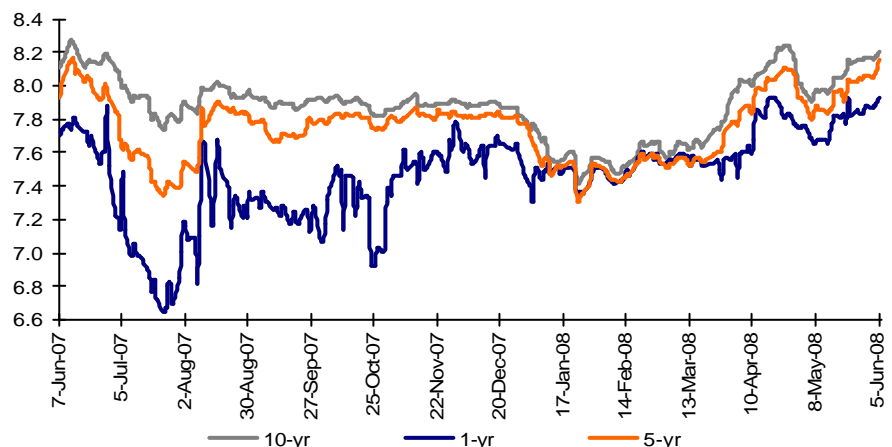
### PSU banks may use occasion to raise rates

Many of the PSU banks have shown their intentions to raise rates post the announcement of the increase in the repo rate. We believe that these banks would just be using the occasion to roll back the PLR cut which they did in Q4FY08. We believe that this would help them to recoup a part of 10-15bps dip in NIMs which they suffered in Q4FY08.

### Hike already in price; valuations at four year low

We believe that one more round of monetary tightening after the CRR hike was already in price, with bond yields already having moved up by 10-20bps across the tenures after the monetary policy announcement in April 2008.

#### Bond yields (%)

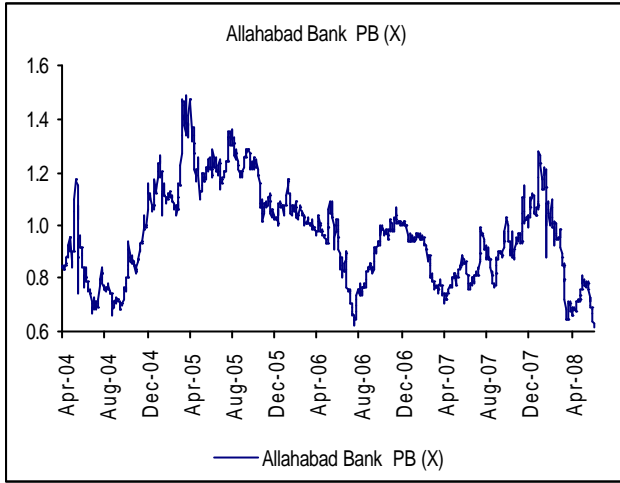


Source: Bloomberg, Emkay Research

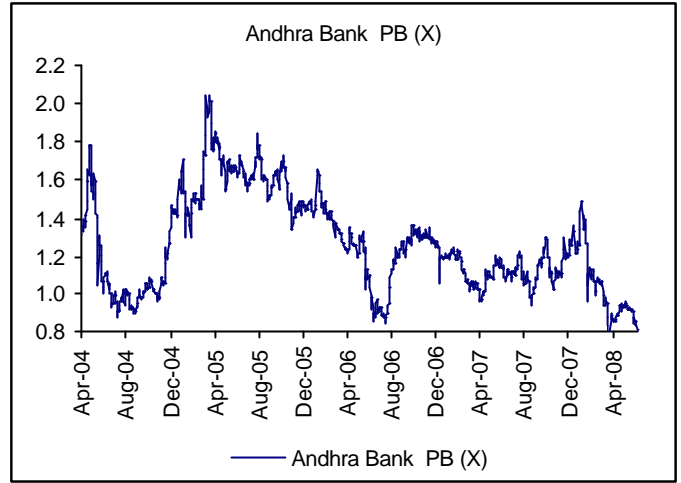
With major monetary tightening having taken place in Q1FY08, the July review of monetary policy may be non-eventful. Alongside, the valuations for banking stocks have also taken significant beating and in most cases they are quoting at their four year low valuations (see the charts).

We find the valuations of the banking stocks very attractive and maintain our positive view. Our top picks – ICICI Bank, Axis Bank, HDFC Bank, BOB and BOI.

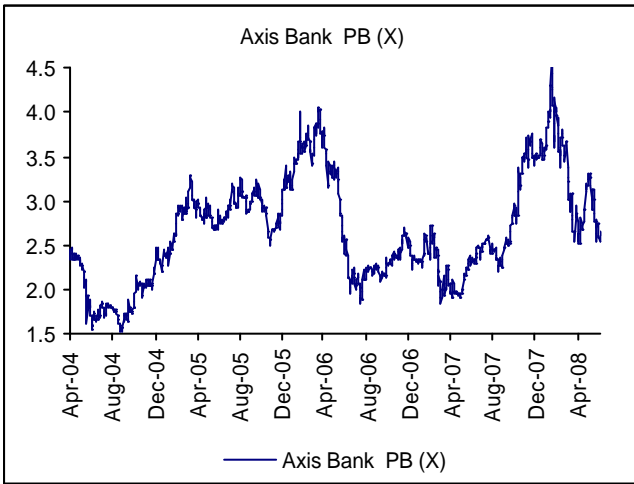
Allahabad Bank –P/ABV (1-yr forward on rolling basis)



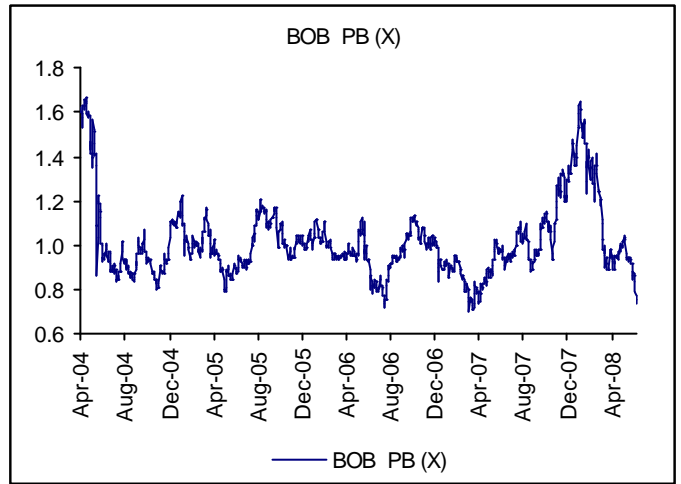
Andhra Bank –P/ABV (1-yr forward on rolling basis)



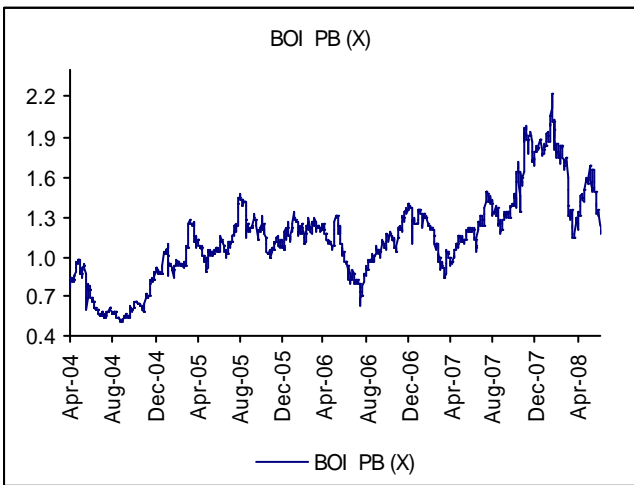
Axis Bank –P/ABV (1-yr forward on rolling basis)



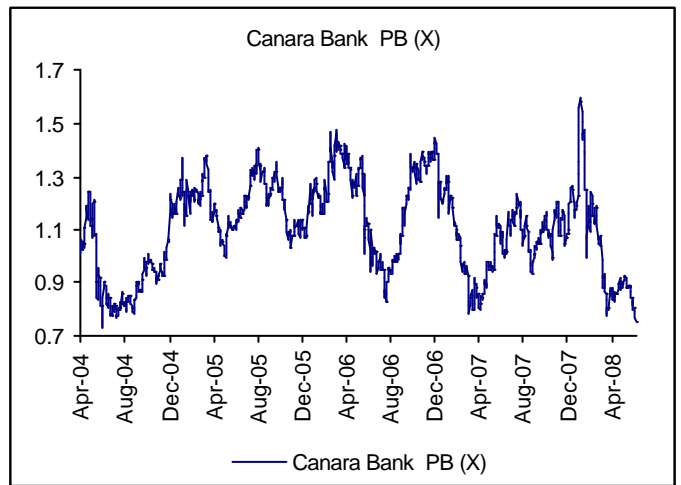
Bank of Baroda –P/ABV (1-yr forward on rolling basis)



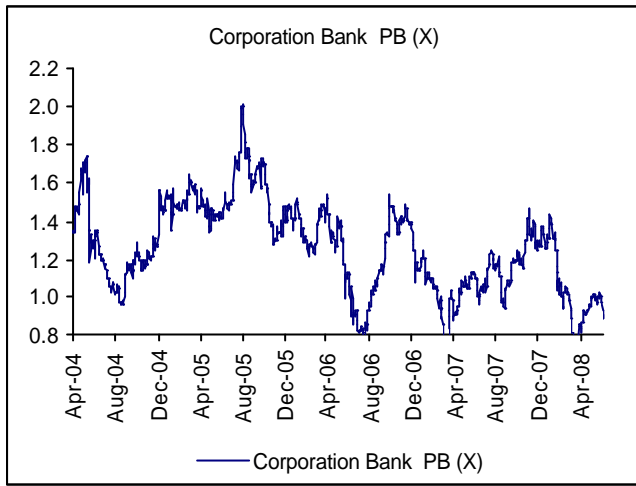
Bank of India –P/ABV (1-yr forward on rolling basis)



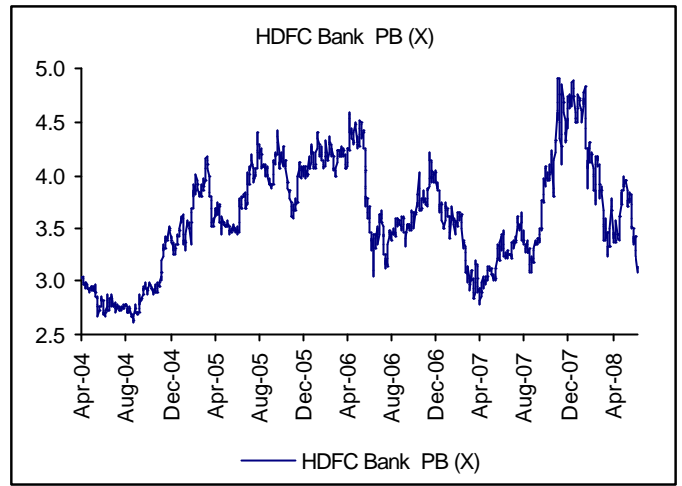
Canara Bank –P/ABV (1-yr forward on rolling basis)



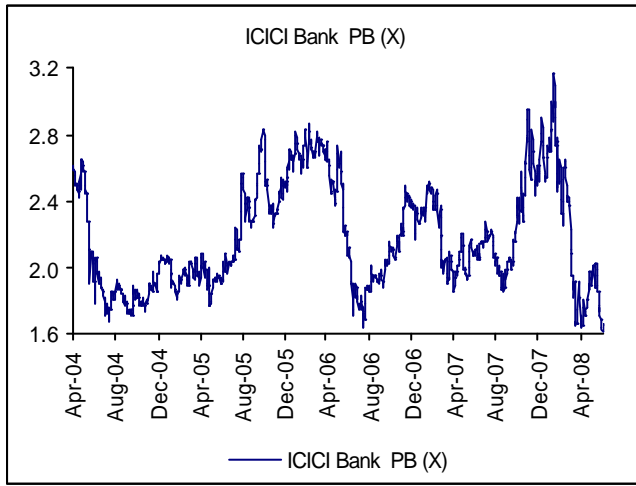
Corporation Bank –P/ABV (1-yr forward on rolling basis)



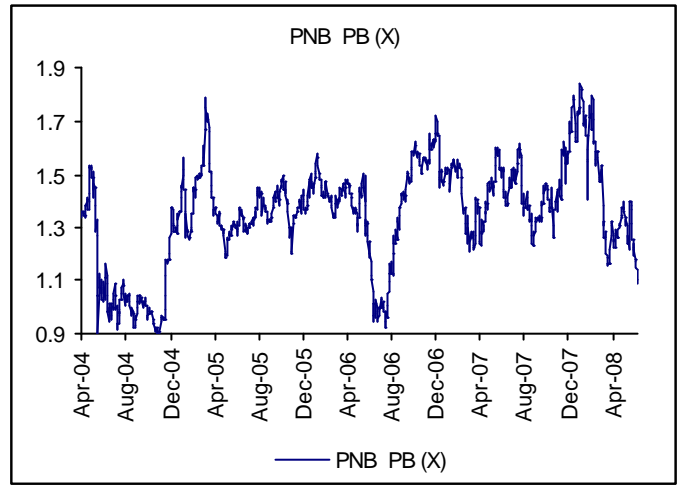
HDFC Bank –P/ABV (1-yr forward on rolling basis)



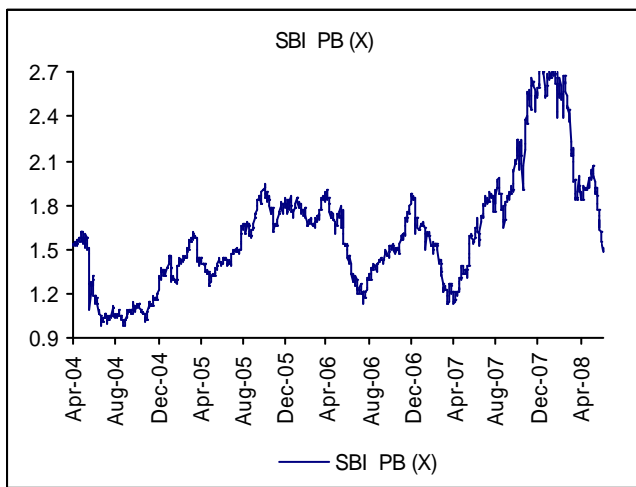
ICICI Bank –P/ABV (1-yr forward on rolling basis)



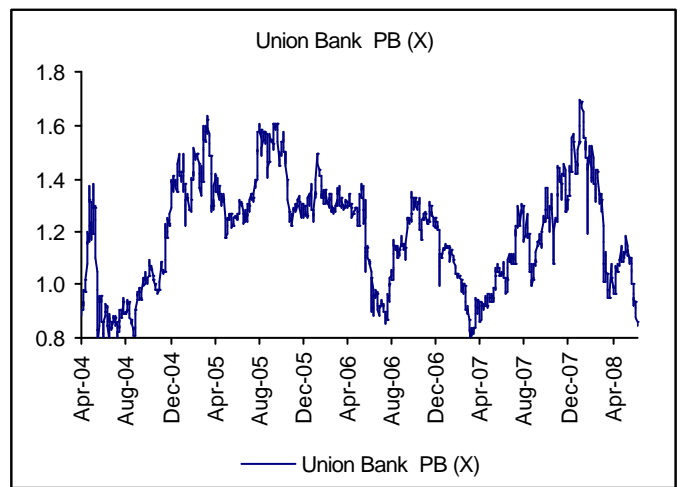
Punjab National Bank –P/ABV (1-yr forward on rolling basis)



State Bank of India –P/ABV (1-yr forward on rolling basis)



Union Bank of India –P/ABV (1-yr forward on rolling basis)



	CMP (Rs)	Reco	PER (x)		P/ABV (x)		P/PPP (x)		RoE (%)	
			FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Allahabad Bank	69	BUY	3.1	2.5	0.6	0.5	2.0	1.7	17.5	18.9
Andhra Bank	67	BUY	4.3	3.6	0.8	0.7	2.4	2.0	19.3	20.1
Axis Bank	704	BUY	17.6	14.8	2.6	2.2	8.4	6.8	15.9	16.6
Bank of Baroda	228	BUY	5.7	4.7	0.8	0.7	2.9	2.4	14.0	15.0
Bank of India	268	BUY	5.8	4.7	1.4	1.1	3.1	2.6	24.4	24.3
Canara Bank	189	REDUCE	4.4	3.7	0.8	0.6	2.3	2.0	17.5	18.3
Corp Bank	324	BUY	6.1	4.9	1.0	0.8	3.1	2.6	16.8	18.0
DCB	57	BUY	17.4	9.2	1.2	1.1	8.6	5.7	8.2	12.3
HDFC Bank	1,185	BUY	19.9	15.4	3.2	2.6	8.6	7.1	16.8	18.3
ICICI Bank	742	BUY	15.0	11.5	1.7	1.6	8.0	6.2	11.3	13.5
PNB	448	BUY	6.5	5.5	1.1	0.9	3.0	2.6	17.4	17.8
SBI	1,310	BUY	11.9	10.2	1.7	1.5	5.9	5.1	12.6	13.3
UBI	123	BUY	4.8	3.9	0.9	0.8	2.6	2.1	20.1	20.3
Yes Bank	137	BUY	14.1	8.6	2.1	1.8	8.2	5.2	18.3	22.0

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